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IN THE

Supreme Court of the United States

OCTOBER TERM, 1936

No. 563.

PARK L. HOFFMAN, Substituted for R. G. HOLSING, Receiver of First National Bank of Boswell, Pennsylvania,
Petitioner,

v.

HENRY I. RAUCH, Administrator, Emiline B. Rauch, late of Jenner Township, Somerset County, Pennsylvania,
Respondent.

REPLY BRIEF OF PETITIONER.

GEORGE P. BARSE,
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Attorneys for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

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In his short brief the respondent cites the following four Federal decisions as supporting the contention that a trust can be impressed upon the assets that passed to the Receiver in this case:

Peters v. *Bain*, 133 U. S. 670.
Kershaw v. *Jenkins*, 71 Fed. (2nd) 647 (C. C. A. 10th).
Schumacher v. *Harriett*, 52 Fed. (2nd) 817 (C. C. A. 4th).
Frelinghuysen v. *Nugent*, 36 Fed. 229.

On page 2 of his brief the respondent quotes part of the excerpt from the opinion in Frelinghuysen v. Nugent quoted by this court at page 693 in its opinion in *Peters* v. *Bain*. Had the respondent continued the quotation plus this court's comment thereon, which we quote from pages 693 and 694, he would have established that Peters v. Bain supports the position of the petitioner and not that of the respondent:

> " 'This is as far as the rule has been carried. The difficulty of sustaining the claim in the present case is, that it does not appear that the goods claimed—that is to say, the stock on hand, finished and unfinished—were either in whole or in part the proceeds of any money unlawfully abstracted from the bank.' The same difficulty presents itself here, and while the rule laid down by Mr. Justice Bradley has been recognized and applied by this court, National Bank v. Insurance Company, 104 U. S. 54, 67, and cases cited, yet, as stated by the Chief Justice, 'purchases made and paid for out of the general mass cannot be claimed by the bank, unless it is shown that its own moneys then in the fund were appropriated for that purpose.' And this the evidence fails to establish as to any other property than that designated in the decree, * * *"

In the instant case we know what happened to the respondent's bonds. They were used by the bank to reduce its debts to others. Neither the bonds nor any proceeds therefrom passed to the Receiver.

Kershaw v. *Jenkins*, 71 Fed. (2nd) 647, also supports the position of the petitioner and not that of the respondent. Jenkins' check was charged against his pre-existing credit balance to purchase Liberty bonds, and the bank's cashier's check was issued but no bonds were purchased or segregated from those held by the bank, prior to its suspension. The Appellate Court held that the case fell within *Blakey* v. *Brinson*, 286 U. S. 254, and reversed the trial court's allowance of a trust against the bank's assets that passed to the Receiver.

It cannot be denied that *Schumacher* v. *Harriett*, 52 Fed. (2nd) 817, gives the respondent assistance to the extent that it holds that if a bank misuses a claimant's property it must be deemed to have set apart as a trust res an equivalent value of its cash assets. We submit, however that, to this extent, Schumacher v. Harriett does not correctly state the Federal rule. In commenting upon this phase of the Harriett decision, the Circuit Court of Appeals for the Fifth Circuit said in *Pottorff* v. *Key*, 67 Fed. (2nd) 833, 834:

> "Such a doctrine amounts to saying that in every case of misapplied money or money's equivalent the wrongdoer's other cash and cash items stand in its place so long as he has any, establishing in effect a general lien on all such. 'If the plaintiff's contention be well founded, and to follow misappropriated moneys it is only necessary to show that a receiver has, and that the trustee had, assets, the rule is simply that a demand for such moneys is a preferred claim against any substantial estate. To adopt this view is to do away with all the equitable principles out of which the right to follow trust funds grew.' American Can Co. v. Williams (C. C. A.) 178 F. 420, at page 423. We hold in this connection that, if a trust res can be followed, it must be; and that a lien by confusion can be fixed on a fund only when the confusion is actual and when the fund is shown to have really received and to still contain the trust res or its proceeds. The judgment is reversed, with direction to disallow appellee's claim as preferred and to allow it as a general claim only."

Schumacher v. *Harriett* was a companion case to *Schumacher* v. *Brinson*, which was reviewed by this court and reversed as *Blakey* v. *Brinson*, 286 U. S. 254. Judge Parker, the author of the opinion in *Schumacher* v. *Harriett*, wrote the opinion in *O'Neal* v. *White*, 79 Fed. (2nd) 835, certiorari denied 297 U. S. 706, discussed in our main brief, page 8, and denied a trust claim wherein the controlling facts are almost identical with those in the instant case. The liberal tracing rule of *Schumacher* v. *Harriett* was relied on by the Circuit Court of Appeals for the Seventh Circuit in

impressing a trust on the assets of a National bank that passed to the Receiver in *Adams* v. *Champion*, 70 Fed. (2nd) 956, but the Harriett rule was in effect rejected by this court when it reversed the Appellate Court in 294 U. S. 231.

We do not believe it necessary to discuss the minority view reflected in the State decisions cited by the respondent. The reasoning of these State decisions was rejected by this court in the recent cases cited at pages 6 and 7 in our main brief and by many decisions of the lower Federal Courts. This conflict is treated at length in a comprehensive annotation in 82 A. L. R., pages 46 to 288, and the State decisions listed in the opinion of the court below (R. 36) will be found at page 50 of the annotation.

On Page 2 of "appellee's brief" respondent seems to suggest a distinction between a trust "ex maleficio" and a trust arising by formal agreement of parties. He does not, however, seem to indicate any difference as to the necessity in each case of augmentation and tracing, his discussion being confined primarily to attempting to establish a liberalization of the augmentation and tracing doctrines.

It may be pointed out here, however, that the necessity of augmentation and tracing, as a prerequisite to the allowance of a priority or preferred claim against the assets of an insolvent estate which is being administered for the benefit of all creditors, is just as rigidly required in the case of a trust ex maleficio, as it is in the case of violation of a trust created by formal agreement.

The decision and opinion of this court in *Schuyler* v. *Littlefield*, 232 U. S. 707, 711, 713, is directly in point, by analogy so far as the present discussion is concerned. It appears that Brown and Company, who were brokers in New York City, obtained certain shares of stock from the plaintiffs by fraudulent representations. At that moment a trust ex maleficio or constructive trust arose and Brown and Company became trustees ex maleficio with the shares of stock constituting the *res* of said trust. Thereafter they sold the stock and received certain checks in payment,

and deposited said checks in bank and subsequently apparently checked out the proceeds arising from the sale of said stock. The court disallowed the preference claim and in that connection said:

> "It thus appeared that the stock fraudulently obtained by Brown & Co. had been sold by them, with other stock, to Miller who paid for the whole in two checks—one for $266,600 deposited to Brown & Co.'s account in the Hanover National Bank on August 24th, and another for $23,000 deposited in the same bank on August 25th.
>
> 1. If the trust fund of $9,600 was included in the check for $266,600, then it was dissipated except to the extent of $6,180.17, which was the sum left to Brown & Co.'s credit at the close of business on August 24th. And inasmuch as all of that balance was paid out early the next day, the trust fund was thereby wholly dissipated so far as the bank account was concerned.
>
> If, however, the trust fund of $9,600 is to be treated as having been included in Miller's check for $23,000 then a similar result follows, though on this point the evidence of the witnesses and the findings of the two courts are in conflict.
>
> * * * * * * *
>
> It would serve no useful purpose to make a detailed statement of the testimony. The evidence has been fully discussed by the Court of Appeals (193 Fed. Rep. 24-33) in considering this claim of appellants along with that of several other parties seeking, on somewhat similar facts, to trace trust funds into the bank and thence into collateral which ultimately came into the hands of the Trustee. All these claims were disallowed because of the failure to make the requisite proof. Our investigation of the facts leads us to the same conclusion so far as concerns the appellants' claim. They were practically asserting title to $9,600 said to have been traced into stock in the possession of the Trustee. Like all other persons similarly situated, they were under the burden of proving their title. If they were unable to carry the burden of identifying the fund as representing the proceeds of their Inter-

borough stock their claim must fail. If their evidence left the matter of identification in doubt the doubt must be resolved in favor of the Trustee, who represents all of the creditors of Brown & Co., some of whom appear to have suffered in the same way. Like them, the appellants must be remitted to the general fund."

Reference in this connection also may be made to our discussion on pages 5 and 6 of our main brief of that portion of this court's opinion relating to the Veesaert bonds in *Adams* v. *Champion*, 294 U. S. 231, 239, where this court said:

"3. The fourth contested item, the collection on the Veesaert bonds, differs from the others in that *payment was received after the trustee in bankruptcy had elected to avoid the preference* and had sued for that relief.

The payment was made as we have seen, by the deposit of $1,597.31 in the First National Bank of Chicago, Illinois.

The balance in that account was reduced in 1931 to $776.57. What became of the difference ($820.74) there is nothing to inform us. *Evidence is lacking that it was withdrawn in such a form or for such purposes as to be represented by any assets forming part of the estate today.* The receiver consents that this item of $776.57, the balance in the Chicago bank, be paid to the respondent as a preferred charge upon the fund.

The decree is reversed and the cause remanded for further proceedings in accordance with this opinion." (Italics inserted.)

Further in connection with the foregoing point we cited and discussed, on Page 8 of our main brief, the case of *O'Neal* v. *White*, 79 Fed. (2d) 835, and stated in that connection that the controlling facts therein were almost identical with the facts in the instant case. The transcript of record in that case is on file in this honorable court in connection with an application for writ of certiorari (which was denied,—297 U. S. 706). The reported opinion of the Circuit Court of Appeals in the case does not give the de-

tails concerning the circumstances under which the bonds were held in trust.

However, if the Court desires to do so, an examination of the transcript of record in that case (at Page 13 thereof) will disclose that the bank held the bonds in its "safekeeping department" for the owner, and that

> "4. Thereafter said bank, on or about 8th and 20th August, 1929, without the knowledge or consent of said guardian, took his said bonds and sold them for the sum of $7,032.47, which it commingled with its assets. Said guardian never ratified such sale of his bonds and was ignorant thereof until after the bank closed."

It may also be noted that in *O'Neal* v. *White* it does not appear that any attempt was made by the bank to purchase other bonds in substitution of the bonds, whereas in the instant case the officer of the bank did endeavor, apparently in entire good faith, on the day after the sale of the bonds, to purchase other bonds for replacement. (R. 20)

The respondent says at page 4 of his brief: "A discharge or reduction of a liability produces a corresponding increase in assets." This contention has always been rejected by the Federal Courts and most of the State courts. To quote from *Farmers National Bank of Burlington* v. *Pribble* (C. C. A. 8th), 15 Fed. (2nd) 175-176, cited by this court with approval in *Jennings* v. *U. S. F. & G. Co.*, 294 U. S. 216, 224:

> "The fact that the claimant's property paid or reduced the indebtedness or liability of the insolvent corporation, so that it will pay a larger percentage of the debts, justifies no lien on its assets by or preference in payment to the cestui que trust (1) because such a reduction of indebtedness does not increase the property or the value of the property of the insolvent; and (2) because the property of the claimant so used to pay a part of the insolvent's general indebtedness or liability never goes into, and therefore cannot be traced into, the property or assets of the insolvent which subsequently come into the possession of the receiver. Titlow v. McCormick, 236 F. 209, 149 C. C. A. 399; American

> Can Co. v. Williams (C. C.), 176 F. 816; Lucas County v. Jamison (C. C.), 170 F. 338; Multnomah v. Oregon National Bank (C. C.), 61 F. 912; Beard v. Independent School District, 88 F. 375, 31 C. C. A. 562; Hecker-Jones-Jewell Mill. Co. v. Cosmopolitan Trust Co., 242 Mass. 181, 136 N. E. 333, 24 A. L. R. 1148."

The respondent suggests, page 2 of his brief, that the large number of bank failures in recent years has led many courts to adopt more liberal doctrines with reference to tracing of funds. We deny that this is so. Certainly the contrary is true of all recent Federal court decisions, including the recent decisions of this court, as pointed out by Judge Raymond, citing many authorities, in his excellent discussion of these claims in *Brown* v. *Botkin*, 13 Fed. Supp. 1000, 1003.

In concluding that the decision of the court below is just and equitable the respondent fails to consider the equal equities of the depositors and other creditors who will suffer a substantial loss through their dealings with the bank and whose funds were in no way enriched by the sale of the bonds. As stated in *Wisdom* v. *Keen*, (C. C. A. 5th) 69 Fed. (2nd) 349, 350, cited by this court with approval in *Jennings* v. *U. S. F. & G. Co.*, 294 U. S. 216, 224:

> "By their mutual intent the bank's relation to Keen was that of a trustee rather than a debtor, but there is still no identifiable trust res traceable as such, but only a liability for a breach of trust in failing to create the res. This liability, absent a statutory priority or lien, has no higher dignity than other general liabilities. As to every general creditor the bank has failed to do what it ought to have done and what it promised to do. The federal statute puts all such claimants on an equality. Even claims due the United States have no preference. Cook County National Bank v. United States, 107 U. S. 445, 2 S. Ct. 561, 27 L. Ed. 537."

Respectfully submitted,

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